

DOCUMENT RESUME

ED 407 611

CE 074 141

TITLE Accounting for People: Can Business Measure Human Value?
INSTITUTION National Alliance of Business, Inc., Washington, D.C.
PUB DATE Apr 97
NOTE 5p.
PUB TYPE Information Analyses (070) -- Journal Articles (080)
JOURNAL CIT Workforce Economics; v3 n1 p3-5 Apr 1997
EDRS PRICE EDRS Price MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS *Accounting; Adult Education; Economics; *Human Capital;
*Human Resources; Job Training; Models; *Productivity;
Resource Allocation; *Staff Development; Vocational
Education

ABSTRACT

Traditional business practice undervalues human capital, and most conventional accounting models reflect this inclination. The argument for more explicit measurements of human resources is simple: Improved measurement of human resources will lead to more rational and productive choices about managing human resources. The business community is investing more time, money, and effort in education and training than ever before. Data from the "1997 Economic Report of the President" show increased education and training account for a larger share of productivity growth and represent a larger absolute amount. In a 1995 study, Margaret Blair reports businesses' capacity for generating wealth increasingly is based on workers' skills and knowledge. Hansen and Wernerfelt's research shows human resource factors are more important in determining firm performance than traditional economic indicators. These studies demonstrate the importance of creating a strategy to measure contributions of human resource assets when measuring overall performance. Companies are struggling with how to measure the return on investment of training and education. Walgreen has successfully compared sales of technicians trained on the job versus those who received formal training. Units have been established within training departments to evaluate and measure the impact of training in such companies as AT&T, Motorola, Arthur Andersen, and Intel. The challenge is to find innovative ways to measure and report the value of human resource assets. (YLB)

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ACCOUNTING FOR PEOPLE

Can Business Measure Human Value?

Traditional business practice undervalues human capital, and most conventional accounting models reflect this inclination. Typical annual reports and financial statements lack information showing the value of human capital; balance sheets have no record of investment in human capital and omit human resource assets — or include them as expenses. But times are changing, and today's forward-looking companies are finding ways to measure and report human resources' contribution to company performance.

The argument for more explicit measurements of human resources is simple: Improved measurement of human resources will lead to more rational and productive choices about managing human resources — and allocating them to improve overall business performance.

Businesses' growing interest in gauging — and maximizing — human resource potential is no surprise. In the past, businesses' most important assets were factories and physical capital, but business prophets agree that in the 21st century, the greatest asset will be people — employees' knowledge, skills and abilities. Competitive advantage increasingly will depend on how companies manage and invest in people. As Peter Drucker observes, managers will need to allocate human resources as purposefully and as thoughtfully as they manage capital to create wealth.

Unfortunately, traditional financial and accounting systems don't encourage — or in many cases, even allow for — such management. These models are outdated, and companies using them to make decisions about improvements and innovations may be misled. Making sound decisions in today's economy requires new financial standards that are forward-looking and help companies think in new ways (see related story, page 5).

Businesses Are Investing in Human Resources ...

Today, the business community is investing more time, money and effort in education and training than ever before. Training is a big and growing business, according to estimates from Lakewood Publisher's Annual Industry Training Report, the Saratoga Institute and estimates derived by the American Society for Training and Development (ASTD).

Last year, companies spent nearly \$60 billion on training, and training investments are growing in real terms — they increased by 18 percent from 1983 to 1995. Business investments in training equal investments in computers and peripheral equipment.

... Because People Are Important

From a macroeconomic perspective, the importance of people to productivity growth has grown over time, making people more and more important to companies.

Data from the 1997 *Economic Report of the President* show that today, increased education and training not only account for a larger share of productivity growth, but also represent a larger absolute amount.

Since 1960, the contribution of education and training to productivity growth has grown ninefold. From 1960 to 1973, growth in education and training represented about 3 percent of recorded increases in productivity; from 1973 to 1994 growth in education and training represented 27 percent of the recorded increases in productivity. Other factors (such as changing technology, R&D and capital investments) have played a role, but increases in education and training are an increasingly important factor in boosting productivity.

"Companies must
define and measure
the true array of
assets that determine
competitive position,
not just those now
on the financial
statements."

— Council on Competitiveness, *Capital
Choices: Changing the Way America
Invests in Industry*

In a 1995 study, Margaret Blair of the Brookings Institution reported that businesses' capacity for generating wealth increasingly is based on the skills and knowledge of their workers — and companies' capacity to use workers' skills to create value for their customers.

Blair found that measures of physical capital (the value of property, plant and equipment) as a share of companies' total market value has fallen dramatically — by more than 24 percentage points in nine years. In 1982, these physical assets accounted for 62.3 percent of the total market value of mining and manufacturing firms; by 1991, they represented only 37.9 percent of these firms' total market value. Eye-opening for any economic sector, these figures are startling because they apply to such capital-intensive industries.

Ann Bartel estimated the rate of return on one company's job training investments in a 1996 study in the *Journal of Labor Research*. Of course, the return on investment depends on how long the new skills remain useful. If skills depreciate at the rate of 20 percent per year (implying a half-life of skills equal to roughly three years), Bartel calculated that education and training investments generate returns in the neighborhood of 20 percent. If skills depreciate at 10 percent per year (implying a half-life of skills of about six years), the rate of return is about 35 percent.

The Strategic Management Journal published research by Hansen and Wernerfelt showing that human resource factors are more important in determining firm performance than traditional economic indicators such as industry, market share and firm size. The researchers measured performance by the five-year return on assets. In addition, research by

Hewitt Associates found a strong relationship between a company's human resource practices and its bottom line.

Walgreen found that sales in pharmacies with formally trained technicians were almost \$10,000 higher than stores with technicians who were trained only on the job.



Reflecting the Data: Reporting Real Value

Economic factors are, of course, still relevant, but these studies demonstrate the importance of creating a strategy to measure contributions of human resource assets when measuring overall performance — and planning for the future.

Some companies already are moving forward with recognizing the value of human resource contributions. The most prominent example

is Scandia AFS, a Scandinavian-based insurance company. Scandia includes a supplement to its annual report that shows several measurements of human resource assets — and how they contribute to company performance. The report includes, for example, level of employees' education and training, employee turnover and retention figures, and corporate culture factors.

Other companies, such as the Canadian Imperial Bank of Commerce, Dow Chemical and Southern California Edison, also are working on ways to measure and report on the value of human capital to their companies.

Measuring the Value of Training Is Difficult ...

Investments in human capital often begin with training. As companies increasingly focus on training to improve performance — and build the bottom line — human resource professionals are challenged to ensure that these investments deliver the intended outcomes. Many are struggling with how to measure the return on investment of training and education.

Recent reports from the Saratoga Institute and the ASTD suggest that many companies still have a long way to go. Two studies published by the organizations looked at companies engaged in their respective benchmarking projects and found that few companies were using methods that measured the organizational results of investments in training and education (for example, return on investment, fewer errors or increased sales). The Saratoga Institute reports, however, that companies that weren't measuring the return on their investment increasingly were turning to outside vendors that promised to document improved performance.

... But Can Be Successful

Some companies have been able to show the value of training. When the drug store chain Walgreen developed a new training program for its pharmacy technicians, decision-makers wanted to measure the program's effect. Walgreen compared the sales of two groups of its pharmacies: those with technicians who received only on-the-job training and those with technicians who received the formal training. Sales in pharmacies with formally trained technicians were almost \$10,000 higher than stores with technicians who were only trained on the job.

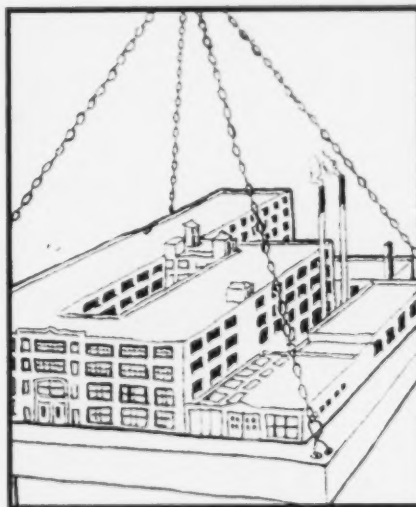
Companies such as AT&T, Motorola, Arthur Andersen and Intel have created units within their training departments to evaluate and measure the impact of training. John Boudreau and Peter Ramstead of Cornell report on how Sears, Roebuck and Company created a system that measures and connects training investments to store outcomes. And the National Association of Manufacturers currently is working to provide companies with simple and usable methods to calculate returns on investment in training and education.

Implications

Several issues of *Workforce Economics* have highlighted the value — and bottom-line impact — of human resource innovations, including education and training, high-performance workplace practices and alternative pay systems.

A recent article on investments in information technology (*Workforce Economics*, December 1996) showed that investments in education and training are the critical factor in ensuring that technology investments improve company productivity.

"Members of the accounting profession ... have fretted openly about how to inform potential investors of the true worth of enterprises whose value rests in the brains of employees."



More and more businesses understand the value of investing in people. The next challenge is to find innovative ways to measure and report the value of human resource assets — a task that decision-makers, human resource professionals and financial officers must tackle together. The greatest challenge may be to accountants and financial analysts who must devise accounting standards that reflect the contributions of companies' human resources.

Resources for Business

Experts Agree: Put People in the Equation

It is a challenge for businesses to shift their thinking about human resources. Research shows the value of measuring human resource contributions — and making business decisions that maximize their role in the bottom line.

If you want to move your company in this new direction, check out:

- *Measuring What People Know: Human Capital Accounting for the Knowledge Economy*, Organisation for Economic Cooperation and Development (1996).
- *Intellectual Capital: The New Wealth of Organizations* by Thomas Stewart (1997).
- "The Official Intellectual Capital Home Page," Institute for Intellectual Capital Research. <http://www.business.uwo.ca/~nbontis>. Contains links to publications, researchers, companies, software and comments on the notion of intellectual capital.

As former U.S. Secretary of Labor Robert Reich observed, "Members of the accounting profession, not otherwise known for their public displays of emotion, have fretted openly about how to inform potential investors of the true worth of enterprises whose value rests in the brains of employees."

WORKFORCE ECONOMICS

Workforce Economics is published bimonthly by the National Alliance of Business, 1201 New York Avenue, NW, Suite 700, Washington, DC 20005, 202/289-2888. For more information, contact: National Alliance of Business, Member Services Center, P.O. Box 501, Annapolis, MD 20701, 800/787-7788.

The National Alliance of Business is an independent, nonprofit, business-led organization committed to building partnerships to solve issues related to the quality of our nation's education system, workforce and job training programs. The Alliance directs programs, creates public awareness, shapes public policy and builds coalitions and partnerships.

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